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**Case Study**

**Rural Financial Institutions: Start-Ups**

**The Case Study of ACLEDA Bank**

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This case study was made possible by support provided in part by the US Agency for International Development (USAID) Agreement No. LAG-A-00-96-90016-00 through Broadening Access and Strengthening Input Market Systems Collaborative Research Support Program (BASIS-CRSP) and the World Council of Credit Unions, Inc. (WOCCU).

All views, interpretations, recommendations, and conclusions expressed in this paper are those of the author (s) and not necessarily those of the supporting or collaborating institutions.

## **1- Introductory Information of Cambodia**

### **Overview of Commercial Banks in Cambodia**

Cambodia's banking system remains underdeveloped. There are currently 17 banks that were active in 2002: 13 commercial banks (one state owned, 3 foreign bank branches and 9 locally incorporated banks), 4 specialized banks (one state owned and 3 privately owned). Beside those 17 banks, there are 3 licensed micro-finance institutions are also active in providing financial services in Cambodia in 2002.

After the May 31<sup>st</sup> 2000 banking re-licensing and restructuring accordance with the 1999 Banking and Financial Institutions Law took effect.; 15 banks were closed (10 voluntary closed and 5 liquidated); 13 banks were awarded full commercial banking license; and 4 banks were granted as a license to operate as specialized banks. During the banking restructuring, there are 3 micro-finance institutions were granted a license and other 59 NGOs were registered with the NBC.

Those 13 commercial banks are: Foreign Trade Bank (State owned); 3 Foreign Bank branches are: First Commercial Bank, May Bank and Krung Thai Bank; and 9 locally incorporated private banks are: Advance of Asia Bank, Cambodia Asia Bank, Canadia Bank Ltd., Cambodia Commercial Bank, Cambodia Mekong Bank, Cambodia Public Bank, Singapore Banking Corporation, Union Commercial Bank, and Vattanac Bank. The other 4 specialized banks are Rural Development Bank (state owned) and 3 privately owned are ACLEDA bank Limited, Peng Heng SME Limited and Cambodia Agriculture Industrial Specialized Bank.

#### **1.1 Law on Banking and Financial Institutions**

1. Commercial Banking Activities: Pursuance to the Article 2 of the law on Banking and Financial Institutions a bank can do full banking activities as follows:
  - a. Credit operations for valuable consideration, including leasing, guarantees and commitments under signature;
  - b. The collection of non-earmarked deposit from the public;
  - c. The provision of means of payment to customer and the processing of said means of payment in national currency of foreign exchange.

#### **1.2 Introduction of ACLEDA Bank**

ACLEDA was established in January 1993, as a national NGO for Micro and Small Enterprises Development and Credit. From the earliest days ACLEDA received the support of a number of major international development agencies. Two factors, namely expansion of our network to cover 14 of Cambodia's 21 provinces and our ability to operate at a profit to ensure our sustainability, led both our Board and our international partners to conclude that ACLEDA should be transformed into a bank. This would not only provide a secure regulatory framework lacking under our previous status but would enable us to enlarge our range of funding options (e.g. equity injection, taking public deposits, obtaining commercial inter-bank loans) to support expansion of our core micro-finance business. The Ministry of Commerce issued ACLEDA a Certificate of Incorporation as a Public Limited Liability Company

in August 2000. ACLEDA completed the transformation from NGO to a bank and the National Bank of Cambodia granted ACLEDA a license on October 7<sup>th</sup>, 2000.

Under the process, the existing NGO transferred the assets and on-lent its liabilities (long term loans from donors) to the new ACLEDA Bank. In return, it received 32% of the Bank's capital of US\$4 million; the ACLEDA Staff Association, a trust established to give its staff an equity interest, will purchase up to 19% and the remaining 49% has been taken up in equal parts by four foreign investors, namely the International Finance Corporation (part of the World Bank), DEG (Germany), FMO (Netherlands) and Triodos Doeun (Netherlands).

ACLEDA has expanded its business achieving an average portfolio growth rate over 15% p.a. since 1997. At the transformation, ACLEDA had loan portfolios of US\$15,462,166 million to 56,706 borrowing customers (averaging approximately US\$273 per loan) of which nearly 80% are women. Our market share is more than 60% amongst the MFIs, and growing. ACLEDA Bank currently employs 971<sup>1</sup> staff in 76<sup>2</sup> offices in 14 provinces and has loan portfolios of US\$31,307,229<sup>3</sup> to 87,103 borrowing customers. Currently ACLEDA Bank's total assets are approximately US\$35.9 million.

### **1.3.1. Mission/Vision**

The mission and vision of ACLEDA Bank is to market a superior nationwide delivery of high-quality bank products and services at premium prices to meet the needs of the financial and commercial sector and the general public throughout Cambodia in a context where such products and services are presently of indifferent quality and limited to only a very few major towns.

### **1.3.2. Corporate Objective**

The objective of ACLEDA Bank will be to maximize shareholder value by providing and selling ACLEDA Bank commercial and retail products and services targeted at the general public and MSE/SME segments as well as selected services such as Cash Management specially developed for the larger organizations in the financial and commercial sector (e.g. banks, microfinance institutions, NGOs, national and multinationals and government).

### **1.3.3 ACLEDA Bank at Transformation stage**

In ACLEDA's experience, there are three criteria, which we had to meet before taking this step of transformation:

1. ACLEDA needed to be fully sustainable in four aspects:
  - Programming- having the right products and Business plan.
  - Technical- having the right skills and training to meet the business plan.
  - Organizational- having the right management structure and network and
  - Financial viability- controlling costs, ensuring portfolio quality and repayment regularly, and pricing loan products to cover administrative and funding costs.

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<sup>1</sup> as at March 31<sup>st</sup>, 2003

<sup>2</sup> as at March 31<sup>st</sup>, 2003

<sup>3</sup> as at March 31<sup>st</sup>, 2003

2. ACLEDA needed to achieve at least financial break even.
3. ACLEDA needed to meet the National Bank of Cambodia's (the Central Bank) criteria to qualify for a banking license among the most important of which for to strengthen our capital base, diversify our ownership (ie. shareholder) structure and reinforce management.

#### **1.3.4 Network of ACLEDA Bank**

**Outreach Structure:** Geographically, ACLEDA Bank has expanded to have the largest network in Cambodia, which will benefit to savings, transfer, and other financial services. More district offices and service posts got established to be at the closed length to the customers in order to be more convenient and serve them quickly. There are 21 provinces in Cambodia, of these 21 provinces; ACLEDA Bank has operated in 15 provinces and town with 76 provincial branches and district offices. ACLEDA Bank management believes that having offices closed to the customers, ACLEDA Bank can serve the customers better and faster. It is more convenient to both ACLEDA Bank and customers. Furthermore this is the competitive advantage of ACLEDA Bank whereby the other commercial banks cannot do the same at this stage.

#### **1.3.5 ACLEDA Bank Customers and their Benefits**

All ACLEDA Bank target groups are the entrepreneurs of micro and small businesses, and medium sized enterprises; and the general public who are living in both urban and rural areas including the farmers in Cambodia. The customers of small and micro businesses and a plus can have the place where they can depend on in terms of financial services: they can either borrow or deposit with the ACLEDA Bank. Furthermore they don't need to travel from their business location to the suppliers or the other way round. If they want to pay off the purchase on credit or collect the sale on credit, ACLEDA Bank is the meeting point for the service payment and fee collection for those entrepreneurs and companies

#### **1.3.6 ACLEDA Bank Employees**

By the end of March, 2003, ACLEDA Bank employed 971 employees (771 males, and 200 females) detailed below:

- Management	: 52
- Credit officers	: 381
- Accountants	: 97
- Cashiers	: 164
- Marketing staff	: 41
- Information Technology	: 13
- Internal Audit staff	: 29
- Loan recovery officer	: 33
- Saving Account officer	: 8
- Legal officer	: 3
- Administrative officer	: 60
- Security officer	: 90
<b>Total staff</b>	<b>: 971</b>

### **1.3.7 ACLEDA Bank Products and Services**

**Loan Products:** They are for micro business, small and medium enterprises. Those loans are provided to service, trade, manufacturing, agriculture, and agriculture related activities. All loans are provided at ACLEDA Bank branches and offices, and the loan repayment is also done at ACLEDA Bank branches and offices. ACLEDA Bank credit officers only collect the loan repayment after they are defaulted.

- Micro-business or group Loan up to below US\$380. It is a group guaranteed loan whereby the members guarantee each other. In case one member cannot pay, the other members will pay for them.
- Small Business loan. Loan size from US\$380 up to below US\$10,000. It is an individual loan. In order to have access to this loan, the customer must have business ideas, technical skills, permanent location (residence at least one year). Small business loan is collateralized loan.
- Medium size business/ Small-scale industry loan: The loan size is from US\$10,000 up to US\$70,000. It is collateralized loan.

### **1.3.8 Other Products and service:**

Additional products and services are added to the financial services, such as:

- Savings: for the public and households. (This service has been established in 2001).
- Fixed deposit (one month, 3 months, 6 months, and 12 months).
- Current deposit: This product is popular among company, NGOs, government and donor projects
- Local fund transfer: Since ACLEDA Bank has the most branches and offices, this service are important for the rural people. Fund is transferred from Phnom Penh (capital city of Cambodia) to the provinces or districts or the other way round.
- Cash Management service: Distribution collection, supplier payment, payrolls, and overdrafts.
- In house exchange: Because ACLEDA Bank is a specialized bank, exchange is allowed only for the in house customers.

### **1.3.9 Lending Methodology**

ACLEDA Bank targets the lower segment of the market and provides loan to both individual (small business loan) and group (micro business loan). To be eligible for individual loans, the applicants must qualify according to the following criteria:

- a) Land and building or substitute owners
- b) Resident in the areas where a branch office is operating. This requires the certification of local authority.
- c) Unwilling to move from the areas until the loan is completely collected. This requires affirmation of borrower with witness by local authority.
- d) Their ability to repay their loans enhancing by a profitable businesses or secure sources of income.

#### **1.3.9.1 Guarantee**

- a) Collateral (land or building) and/or guarantor .The guarantor must have ability to pay for the loan in case of default.
- b) The guarantor must have his/her own separate business.
- c) Other requirement are also required depend on the level of risk of the loan. It is applied to the loan of KHR 15,000,000.00 (approx. US\$380) and a plus up to 5% of the net worth, for Loan over THB 150,000.00 and over US\$4,000.00 up to 5% of net worth and Certified by local district or provincial land title department.
- d) Other requirements in harmony with the estimated risk level have to secure:

### **1.3.9.2 Requirement**

Borrowers must:

- a) Be able to repay the loan at ACLEDA branch offices.
- b) Be able to repay their loans according to the repayment schedule.
- c) Be able to seek for guarantor/s to repay for, in case of default
- d) Loan Request is not over 67% of ability to repay.
- e) Be able to contribute at least 20% of total investment by their own capital.
- f) Loan Request is not over or equals 100% of total value of their fixed asset.

### **1.3.9.3 Group Loan**

The group loan uses a group guarantee methodology, of which 2 to 10 members can form a group.

### **1.3.9.4 Loan Guarantee**

Group guarantee, and sometimes, collateral is required.

### **1.3.9.5 Requirement**

Borrowers must:

- a) Be able to repay the loan at ACLEDA branch offices.
- b) Be able to repay their loans according to the repayment schedule.
- c) Group guarantee
- d) Loan Request is not over 67% of ability to repay.
- e) Be able to contribute at least 20% of total investment by their own capital.
- f) Loan Request is not over or equals 100% of total value of their fixed asset.

Business plan is required for all types of loans and the customers must agree to all loan conditions mentioning in every document and they must witness by putting their thumbprints on the documents.

## **2- Result and Impact**

### **2-1 Institutional Achievement from 2000-2002.**

2000	2001	2002
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No. of branches	28	66	75
No. of professional staff	463	662	864
No. of active borrowers	60,860	81,453	82,976
Av. Loan size	147	177	132
PF o/s end period	\$16,647,328	\$20,980,016	\$27,461,933
Av. PF o/s per staff	\$35,955	\$31,692	\$31,785
Av. No. clients per staff	131	123	96
Adm. costs / av. PF o/s	25%	28%	24%
PF yield	51%	48%	34%
PF at risk	6.59%	5.88%	2.10%
Op. Self-Sufficiency	208%	174%	142%
Fin. Self-Sufficiency	138%	107%	110%

## 2-2 Operational and financial Highlight of ACLEDA Bank

### Summary Financial Information

#### **BALANCE SHEET**

	2000	2001	2002
<b><u>ASSETS</u></b>			
Cash in hand	1,114,747	1,922,296	1,436,055
Cash at banks	1,325,951	52,634	43,534
Reserves at Central Bank	2,685,468	2,996,342	353,021
Net Loans and Advances	16,040,390	20,114,804	26,965,145
Other Current Assets	560,261	492,767	705, 654
<b><u>Total Current Assets</u></b>	<b>21,726,817</b>	<b>25,578,843</b>	<b>29,503,409</b>
Net Long Term and Fixed Assets	567,897	1,762,286	1,466,686
<b><u>Total Assets</u></b>	<b><u>22,294,714</u></b>	<b><u>27,341,129</u></b>	<b><u>30,970,095</u></b>
<b><u>LIABILITIES AND EQUITY</u></b>			
Deposits	0	1,949,991	5,678,730
Inter-bank Loans	0	500,000	0
Other Short Term Liabilities	915,219	1,717,701	1,725,426
<b><u>Total Current Liabilities</u></b>	<b>915,219</b>	<b>4,167,692</b>	<b>7,404,156</b>
Long Term Debt	5,720,722	6,268,445	6,210,688
Subordinated Debt	11,346,523	12,216,767	12,217,758
Capital and Reserves	4,312,250	4,688,225	5,137,493
<b><u>Total Liabilities and Equity</u></b>	<b><u>22,294,714</u></b>	<b><u>27,341,129</u></b>	<b><u>30,970,095</u></b>

## 2.3 PROFIT & LOSS ACCOUNT

	2000	2001	2002
<b><u>Interest</u></b>			

Interest Income	7,424,434	8,542,102	7,676,049
Interest Expense	(928,349)	(1,699,073)	(973,753)
<b>Net Interest Income</b>	<b>6,496,085</b>	<b>6,843,029</b>	<b>6,702,296</b>
Grant Income	261,867	0	0
Commission	3,551	16,883	131,357
Other Income	299,071	463,726	444,437
<b>Gross Income</b>	<b>7,060,574</b>	<b>7,323,638</b>	<b>7,278,090</b>
Administrative Costs	(3,722,767)	(5,192,019)	(5,808,225)
Provisions	(942,378)	(1,529,472)	(735,866)
Currency re-translation diff.	(4,471)	(8,187)	13,916
<b>Total Operating Costs</b>	<b>(4,669,616)</b>	<b>(6,729,678)</b>	<b>(6,530,175)</b>
<b>Net Profit Before Tax</b>	<b>2,390,958</b>	<b>593,960</b>	<b>747,915</b>
Tax	(83,581)	(118,792)	(158,647)
<b>Net Profit After Tax</b>	<b>2,307,377</b>	<b>475,168</b>	<b>589,268</b>
NGO Retained Earnings	(2,000,645)	0	0
Dividends	(93,675)	(140,000)	(176,800)
<b>Net Retained Earnings</b>	<b>213,057</b>	<b>335,168</b>	<b>412,468</b>

## 2.4.PERFORMANCE RATIOS

	2000	2001	2002
<b>CAPITAL</b>			
CAR (Tier 1 & 2 – BIS formula)	53.78%	26.34%	24.14%
Total Equity/Total Assets	19%	17%	17%
LT borrowings/Total Equity	396%	394%	359%
Interest Coverage Ratio	3.58	1.35	1.77
<b>ASSET QUALITY</b>			
Net Loans/Total Assets	72%	74%	91%
NPL/Total Loans	6.59%	5.88%	2.09%
Open Loan Exposure Ratio	2.65%	2.30%	-0.03%
Loan Loss Provisions/Average Loan Portfolio	4.13%	4.60%	2.40%
<b>EARNINGS</b>			
Return on Average Assets (annualized: pre-tax)	12.51%	2.39%	2.57%
Return on Average Equity (annualized: pre-tax)	30.80%	13.20%	15.22%
Net Interest Margin	33.98%	27.57%	22.99%
Commission	0.05%	0.19%	1.59%



Income/Gross Income			
<b>LIQUIDITY</b>			
Current Assets/Current Liabilities	2175.95%	610%	385.60%
Liquid Assets/Total Deposits	N/A	254.94%	32.27%
Liquid Assets/Total Assets	22.99%	18.18%	5.92%
Net Loans/Customer Deposits	N/A	1031.53%	474.84%
Interbank Borrowing/Total Deposits	N/A	25.64%	N/A
<b>OPERATING</b>			
Total Operating Costs/Average Assets	19.47%	20.92%	19.92%
Total Operating Costs/Gross Operating Revenues	52.76%	70.97%	79.65%
Administrative Costs/Total Operating Costs	92.30%	91.62%	88.64%
Staff Costs/Total Operating Costs	58.33%	56.50%	58.85%

## 2.4 Impact for the customers

There is no impact survey or study if the customers become better after having access to ACLEDA Bank financial services. But ACLEDA Bank can guarantee that the customers can always have access to ACLEDA Bank financial services in both rural and urban areas. ACLEDA Bank has noted that financial intermediation is a vital element in developing local economies and reduces the relative dependence of the country on foreign capital by utilizing domestic savings for investments.

Experience has shown that providing access to financial services to people raises income and creates employment, allows people to improve their liquidity management and increases the efficiency of the use of available capital. Therefore further growth and development of banks/ MFIs will stimulate local economies which are one of the most effective ways to alleviate poverty.

## **3. Challenges with Project Implementation**

### **3.1 Methods used to overcome challenges:**

- Decentralization in decision making so that the branches and offices can make the decision quickly in time for the customers' needs.
- Location- ACLEDA Bank established many branches and offices to be at the close length to the customers.
- Products and services- ACLEDA Bank diversified products and services and sell them according to the market needs and demand.
- Price- Because of the diversification of products and services, ACLEDA Bank has set the prices accordingly so that the customers choose in their satisfaction.
- Promotion- ACLEDA Bank used the existing customers to promote for ACLEDA Bank products and services free of charge.
- ACLEDA Bank chooses the lower segment of the market as the target market whereby the other commercial banks and other financial institutions are discouraged to move in.
- For agriculture lending: Customers are required to diversify their businesses (other business activities in addition to traditional agriculture); Mixed types of agricultural activities; customers are allowed to choose method of loan payment (they can pay principal partly from the beginning and pay at the maturity (at the harvest or crop collection).

### **3.2 Outreach, training and education needed:**

- After the customers have filled in the format of the business plan, ACLEDA Bank provides basic training (business consultancy service) on business plan development to the customers of small and micro businesses.
- For the matter of convenience, most of the training is done at the customers' houses.
- The training is very simple whereby the customers can bring their literate relative with them to help them with the reading and the writing, and calculation for those who are illiterate. The training for business plan development last about two hours in total.
- ACLEDA Bank provides basic training on business plan development that is used as to determine how much loan each customer should obtain, and explain the customers the importance of using banking service to manage their capital properly (information on savings/ deposit; fund transfer; and other bank products.

### **3.3 Management Capacity:**

ACLEDA Bank executive management is responsible for the day-to-day management of ACLEDA Bank and they are policy guided by the board of directors with a broader range of skills and experiences. In order to have the banking operation run smoothly, the executive management established all policies in place, such as: credit, financial, cash management, customer service, internal control, human resource, and staff regulation policies and make sure that all branches and offices of ACLEDA Bank implement strictly. These policies help a lot in decentralization structure of decision

making, especially in the geographical, far remote outreaches, where infrastructures are limited.

A more sophisticated organization like ACLEDA Bank requires more sophisticated IT and MIS systems and the information produced. The IT demands a more disciplined approach to managerial responsibilities in particular the use of management reports. With the sophisticated system, ACLEDA executive management can track down the deficiencies and solve them in time enough before the problems become bigger. As for the branches and offices staff, they can work much more productively.

ACLEDA Bank Management has and continued to focus on five key management areas: Operational Risk, Asset and Liability Management, Internal Control and Audit, and Information Technology have all fully justified the effort invested in them – sometimes in the most trying circumstances. Human Resources of ACLEDA Bank set great store by the quality of its training both for novices as well as regular refresher programs for all senior staff. During 2002 alone 327 training programs – both internal and external – were delivered to 856 or 99 percent of the total staff.

### 3.3.1 Expansion plan in US \$ (2003-2007)

ACLEDA Bank plans to operate a network of 99 branches and offices by the end of the 5-year period. A continued rise in productivity due to planned organizational improvements will further enhance this capacity. In the period of 2003-2007, ACLEDA Bank projects the expansion of its portfolio and client base on the office and network infrastructure as follows:

<b>FINANCIAL PROJECTION</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
Gross loan assets O/S (year end in US\$)	27,484,117	36,084,700	44,052,657	56,727,595	68,645,893	80,480,624
<b>Number of active loans</b>	82,981	93,481	100,470	106,459	111,867	117,515
<b>ROAA</b>	2%	4%	5%	6%	6%	6%
<b>ROAE</b>	13%	14%	15%	20%	21%	22%
<b>Debt/(debt + equity)</b>	84%	67%	70%	72%	73%	74%

Base on the expansion plan, microfinance remains a core business its dominant position in provincial and especially rural areas together with its powerful on-line IT systems have propelled ACLEDA Bank into something more than ‘just another MFI’. With the larger businesses, national and, even, multi-national organizations increasingly using its cash-management services, and the public at large enjoying the benefits of ready access to a whole range of savings and transfer products, ACLEDA Bank has already become the leading supplier of retail banking services in Cambodia. In 2002 the number of depositors grew from 3,636 to 19,070 – an increase of 424 percent – and rose again by another 4,500 by the end of the first quarter this year. To exploit this we must direct it and channel our resources to where we see the best opportunities. ACLEDA Bank’s best future will be the real retailed bank. Management sees that there are four distinct lines of business in which ACLEDA Bank can gain and sustain competitive advantage:

- Micro and small scale credit (our traditional business);
- Small to medium enterprise banking including credit and, later on, other services such as foreign exchange and trade finance – when appropriate;
- Retail Banking (deposits and credit) – to the general public;
- Cash management services (transfers, collections, payrolls, etc.) – to all sectors including commercial, national and multi-national companies, financial institutions, government and development agencies.

### **3.3.2 Risks and their mitigation**

The risks attached to this project fall into five categories and may be summarized as:

Country – Cambodia still carries a heavy risk weighting in the international financial markets, although there has been some indication that attitudes may be changing as the recent political and financial stability looks set to continue. For many, a key indicator will be the forthcoming elections due in the middle of the year but we do not expect any major upheavals as the experience of the last two elections – the most recent being only last year – suggests that the democratic process is, albeit gradually, becoming an established part of the Cambodian polity.

Market – Recent reforms have done much to strengthen the financial system and those banks which survived the purge on capital adequacy and managerial competence may now be regarded with considerably more confidence than before. The next steps will include the formation of an inter-bank market to facilitate the recycling of resources and increase liquidity in the banking system. This will inevitably make the market more sensitive to international interest rate movements – especially as it is expected that ACLEDA will be one of the more active players. However, the bank's Asset and Liability management team has come of age and may be confidently relied upon to manage the risk so as to avoid undue exposure. As for F/X risk, ACLEDA is blessed, through the Subordinated Debt arrangement – with a unique mechanism to quickly square off any position and its current policy is to maintain mismatches at less than 1% of net worth.

Credit – It would be reasonable to suppose that such a dramatic increase in size and capital base might tempt the bank into an over-ambitious expansion of the loan portfolio. Whilst it is true that management are indeed contemplating growth, such is the unsatisfied demand in its existing market segment (i.e. a known product and credit risk) this can largely be achieved without noticeably impacting on the portfolio risk profile. However, it is also true that management are planning to introduce some new loan products which are designed to test the upper levels of its customer segment (MSEs/SMEs) but revenues and volumes are not expected to have a material impact in the early years. (These will be referred to the Board for consideration at the appropriate time.)

Business – The risks inherent in the business environment are more complex and depend heavily on the still fragile economic structure. However, ACLEDA is better positioned to weather any upheavals (as it has demonstrated in the past). The sophistication and flexibility of its systems and the strength of its network enables it to move quickly into new market segments with new products and diversification of revenue sources. However, ACLEDA will require to upgrade its product development

capability to ensure that risks are identified and addressed as far as possible in advance and this is a senior management objective for 2003.

Operational – It is considered that the biggest risk lies in operations with the main questions being does the bank have sufficient, i) HR, both qualitatively and quantitatively, and, ii) systems (IT and others), to handle the growth? The latter can be quickly answered with a firm ‘yes’ as all systems are new and were implemented in the full expectation that the bank would eventually be ‘going commercial’. (This statement is fully supported by the Management Letter issued by the external auditors for the 2002 annual audit.) For example, if and when appropriate, with very little additional expense, ACLEDA could provide trade finance, ATMs and, even, internet banking. The greatest risk does seem to be that the expansion plan will be heavily dependant on a reliable stream of high calibre recruits, the facility to ensure that they are adequately trained and given time to develop, and above all to retain them. The portfolio problems of 2001/2002 clearly demonstrated how quickly the situation can deteriorate if the quality of the HR is not up to standard. However, management confronted the challenge and has introduced major improvements with the establishment of a proper HR function and a full commitment to training of both new and experienced staff. The bank accepts that if those standards start to slip for any reason, business growth must also be curtailed.

Political and Economical – A risk could be that policies and legislation for financial institutions may be adopted and changed that are not conducive to the financial viability and sustainability of the bank. However, this risk is considered very low in Cambodia given that the National Bank of Cambodia has frequently reasserted its support for the adoption of a regulatory framework conducive to financial services. This risk is even further mitigated by the National Bank’s showing particular goodwill in having invited (and, be it said, putting some pressure on) ACLEDA Bank to transform into a commercial bank.

Another risk could be that the Ministries and major donors might start large financial services programs for political reasons with subsidized rates and weak loan repayment enforcement. However, this risk is considered very low as the Royal Government has repeatedly stated that it is in favour of supporting the development of the private sector in Cambodia. Also, the Royal Government has repeatedly confirmed their policy of a market approach. Furthermore, a vast array of donors supports the development of an autonomous, self-financing industry in Cambodia.

Continued political and economic instability could have a negative impact on the domestic economy and the ability to attract additional funding and to realize projected deposit growth targets.

A risk also exists that politically inspired statements in the media could encourage delays to or even defaults on loan repayment which can directly impact on all financial institutions including ACLEDA Bank. However, our experience of two such incidents during the past two years gives us confidence in our ability to handle the situation and the record shows that the portfolio returns to normal within only a few weeks.

#### **4 Policy and Donor recommendation based on ACLEDA experience:**

Governance: Check and balance, and to avoid conflict of interests, the separation of the role of the board and the executive management should state clearly. The board only govern the institution not manage the institution, and the executive management should manage the institution in accordance with the guidance made by the board.

Running rural financial service where there is limited infrastructure need strong and full commitment of staff of all levels. Trustworthy is a plus to financial security in the remote area. So in any form of the institution ownership structure, employee or staff should be included from the very beginning by creation of an Employee Share Ownership Program to capturing their enthusiasm and commitments.

The central bank and government's role was a key issue at an early stage as there were many regulatory and licensing issues involved for which there was no precedent in Cambodia. The involvement of our prospective shareholders in the negotiating process was important to success.

Make sure that there is no subsidized credit that might undermined the development of MFIs. Fair and healthy competition is needed to establish the environment conducive for MFIs to survive and grow.

#### **4.1 Ideas for generalizing innovation or technology to new areas or broadening scope.**

Talking about lending to agricultural activities, one might feel negative from the beginning already. They think about high risk sector and less return. However if we do want to include those farmers with other entrepreneurs, we still can find the safe and creative way to integrate them with the other group of the entrepreneurs. Financial services to the rural customers should be done in accordance to the real situation of the specific areas where the organization is operating. For example: the policy for lending to agriculture activities defines that: loan only given to the farmer who owned at least 2 hectares of the land, and the land must be located in the irrigated areas. On the safe side we can encourage the farmers to diversify their business (multi-farming activities), or we can segment of the farming activities (start up, three months before the harvest, or at the harvest) rather than trying to impose on the policy, etc.

Starting the institution to finance rural finance from the beginning rather than starting it as an NGO and transform it at a later stage to be a licensed MFI. The cost of transformation is a lot in terms of legal, consultancy, human resources orientation (change from social to commercial mindset).

#### **4.2 Lessons for donor community to learn from this experience**

Market research has shown time and again that customers choose ACLEDA Bank because of *service*: appropriate products, convenience of the network, speed of deliver, good returns and, above all, confidence in its management and good governance practice. High interest rate is not important for the customers, but quick services or access to lending is.

The environment of bank branches or offices should be established friendly and convenient to the types of customers the bank serves.

For savings and deposit customers, make sure that the bank has the system whereby the customers can withdraw at any branches and offices of the bank.

High security alone is not enough, there should be the inclusion of the bank employees in the ownership structure to create trustworthy and to be able to expand in the remote areas.

## **5.Final Conclusions**

The participation of the staff for the policy development can bring the close communication to staff of all levels. This can ease the policy implementation. Make sure that they (staff) are properly and enough trained to perform their job according to the individual institution standard. Let them make decision (decentralized way). They can make quick decision based on the policy and procedure/ guidelines of the institutions and the customers become more satisfaction.

Create the good environment of internal audit and develop a good culture of auditing within the institution by making sure the staff feel and think that auditing is a helping/assisting not policing. Have the internal audit in place and let them work independently to check periodically and at randomly whether all policies, procedures, and guidelines are properly implemented. Action must be taken for those (staff) that seriously violate the policies.

Customer Services of the institution is meant for all, internal and external customers. Everyone in the institution is under that same customer service policy. Create the convenience service whereby the first trip of the customers to our institution; they can get all information they need for our financial products and services.

Staff Development and Incentive Program are among the keys to the success. They should be developed by matching with the effort of the team (branches), for example: any ACLEDA bank branches that achieved the return on equity of more than 20%; the portfolio at risk (PAR) is less than 10%, achieved the yearly productivity plan, would received the bonus up to two month equivalent their salaries (group incentive).

Only the financial sustainable institution can guarantee the sustainable access for financial services to the micro, small business entrepreneurs including the farmers in both rural and urban area.